Catching the Wave

Breaker Energy Ltd.

ANNUAL REPORT 2004

Experienced Team

Breaker's proven team of top quartile oil and gas professionals have experience in all key disciplines and regions across the Western Canada Sedimentary Basin. A proven track record of success – technical team has worked together at previous companies.

300,000 Acres Undeveloped Land

In a series of proactive and strategic transactions, Breaker assembled an exceptionally large undeveloped land base capable of sustaining exploration and development operations over the long term. The accessible acreage presents opportunities ranging from high impact grassroots exploration to development and exploitation opportunities such as by-passed pay, recompletions and waterflood optimization.

2 Focus Areas

Breaker is highly focused in the High Prairie area of northwest Alberta and Medicine Hat, Provost and Suffield areas in southern Alberta. The two key focus areas were assembled from farm-ins and acquisitions, where Breaker currently operates approximately 85 percent of the current production.

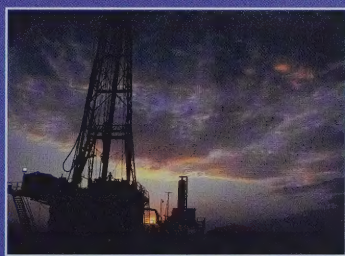
CONTENTS

Annual General Meeting

The annual general meeting of shareholders of Breaker Energy Ltd. will be held at 10:00 am on May 24, 2005 at the Calgary Petroleum Club.
All shareholders are encouraged to attend. Those unable to attend are invited to complete and return the proxy form enclosed.

We are Breaker Energy Ltd.

We're an aggressive junior exploration, exploitation and development company, focused on creating shareholder value by growing per share production and reserves in western Canada. We have high working-interests and operatorship in two key multi-zone focus areas, enabling us to pursue a balanced portfolio of oil and natural gas opportunities.



Breaker will add value through strategic acquisitions as well as through the drill bit, utilizing the team's operational and technical expertise in all disciplines: engineering, geological, geophysical, land and financial. At year-end 2004, Breaker had gained access to more than 300,000 net acres of undeveloped land and attained an exit production rate of 220 boe per day with proved plus probable reserves of 332 thousand barrels of oil equivalent. These accomplishments were achieved within two months of Breaker's initial public offering.

We have only begun to ride the wave of success.

Strategies

Business Plan

In its first few months of operations, Breaker Energy has assembled a core team of professionals and opportunities to build production and reserves. We obtained access to more than 300,000 net acres of land, creating an opportunity base that is focused in two areas: northwest Alberta and southern Alberta.

Breaker's management team has created a well defined business plan focused on building and capturing opportunities that will ultimately provide per share production and reserves growth. The plan is based on an integrated approach to growth by balancing exploration endeavors with strategic acquisitions that provide lower risk exploitation and development opportunities.

We take a proven "team approach" to our day-to-day business endeavors, coupled with attracting and retaining top quartile technical staff with proven track records of adding value.

ACQUISITIONS AND FARM-INS

In November, Breaker signed a strategic farm-in agreement allowing access to approximately 50,000 acres at Suffield, in its Southern focus area.

On December 1, the Company signed a second strategic farm-in agreement in the Medicine Hat area of Breaker's Southern focus area providing access to approximately 115,000 net acres.

On December 7, the Company announced a $9.9 million acquisition that included approximately 300 boe per day of production in its High Prairie focus area, 81,000 net acres of land and 2-D and 3-D seismic. The production consisted of approximately 230 barrels per day of 37° API light oil and 420 mcf per day of natural gas. Immediately after completing the acquisition, Breaker increased the gas production to 630 mcf per day and cut the operating costs in half through field optimization techniques.

IPO AND EQUITY OFFERINGS

Prior to its initial public offering, Breaker raised $1.0 million of private equity, issuing 4,000,001 Class A shares at a price of $0.25 each. On October 27, Breaker closed its initial public offering, raising $10.0 million on a flow-through basis by issuing 4,000,000 Class A shares at a price of $0.25 per share, and 900,000 Class B shares at a price of $10.00 per share.

On December 22, Breaker closed a private placement of 3,850,000 common shares at a price of $2.60 for gross proceeds of $10,010,000.

Acquisition Strategy

Acquisitions are an important part of an E&P company's strategy, providing production for immediate cash flow, opportunities for short-term exploitation and development and undeveloped land for longer-term exploration. At Breaker, we target acquisitions that offer high working-interests, operatorship and complementary undeveloped land that will allow the Company to control the timing and level of expenditures.

We seek areas with multi-zone production potential, which provides uphole or downhole opportunities. These areas should have potential to scale up reserves as we follow up discoveries with large development programs.

We prefer areas that have available access to infrastructure, such as gathering systems and processing plants, to ensure wells can quickly be placed on production. Our focus areas will have year-round access, allowing us to drill and complete wells in all seasons rather than the historically higher cost winter drilling season.

Exploration Strategy

Breaker has assembled a team with well rounded exploration expertise throughout the Western Canada Sedimentary Basin. Our people are highly experienced in 3-D seismic and non-traditional log interpretation techniques, combined with innovative operational evaluation techniques. This combination will ultimately increase the potential for Breaker's success.

We are pursuing scalable and repeatable opportunities by obtaining access to significant land bases through farm-ins, land sales and acquisitions.

2005 YEAR-TO-DATE

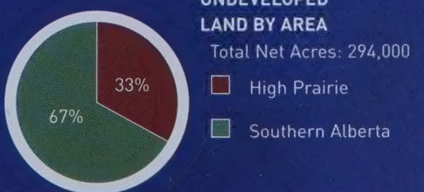
On January 20, Breaker closed the acquisition of 420 mcf per day of natural gas production in its High Prairie focus area for 451,836 Class A shares, $755,000 of cash and the assumption of debt.
On February 8, Breaker agreed to purchase approximately 370 boe per day at Provost in Breaker's Southern focus area for $14.15 million. The concentrated high working-interest property is operated, year-round accessible and consists of approximately 2.1 mmcf per day of natural gas production and 20 barrels per day of medium crude oil (26° API).

EQUITY OFFERINGS YEAR-TO-DATE

On February 25, Breaker completed a $13.2 million private placement, bought-deal financing in conjunction with the Provost acquisition, issuing 3,490,000 Class A shares at $2.90 each and 870,000 flow-through Class A shares at $3.50 each.

UNDEVELOPED LAND BY AREA

Total Net Acres: 294,000



Breaker Management Team

Dan Polley, BSc. (Hons.)
Vice President, Exploration

Mr. Polley discovered the Wymark and Cadillac gas fields, with reserves greater than 100 bcf and current cumulative production of 42 bcf since 1999.

Craig McClelland, B.Comm, P.Land
Vice President, Land

Mr. McClelland has over 16 years of experience leading exploration, acquisition and divestment initiatives in several diverse operating regions in Alberta, British Columbia and Saskatchewan.

Ian Temple, P.Geoph
Manager, Geophysics

Mr. Temple has made numerous discoveries during his 20 years of exploring in western Canada. Significant achievements include assembling a team that put 175 mmcf per day on-stream at Ladyfern in British Columbia.

Dan Baumgarten, P. Eng
Manager, Production Operations

Mr. Baumgarten has experience in gas plant and field operations, facilities and reservoir engineering and managing multi-disciplined teams in the execution of multi-million dollar projects.

Ian Langdon, P.Eng
Vice President, Engineering

Mr. Langdon has over 18 years of experience as a reservoir/exploitation engineer. He has experience in western Canada and Ecuador.

Dan O'Neil, P.Eng
President, Chief Executive Officer, Director

Mr. O'Neil has 23+ years of experience with a proven record of cost effectively optimizing production results. He is a results-driven engineer with a unique and diversified skill-set to work a play from the conceptual stage through to production.

Max Lof, MBA, CFA
Vice President, Finance and Chief Financial Officer

Mr. Lof has 14 years of experience, including public and private equity and debt financings; the valuation, execution and integration of acquisitions; treasury; risk management; investor relations and oil and gas equity research.

Letter to Shareholders

On October 27, 2004 Breaker initiated operations as a publicly traded, junior oil and gas company with the closing of a $10 million flow-through initial public offering. The team moved very aggressively to capture farm-in opportunities and acquisitions of producing properties with exploration and development potential in order to utilize the flow-through funds on high quality exploration prospects. These transactions are outlined in the opening pages of this annual report.

Today, Breaker Energy has all the attributes of a much larger entity: experienced professionals within all key disciplines who are capable of capturing exploration and development opportunities that exist within our large undeveloped land base.

The technical team members have been responsible for significant reserve additions which have added considerable value to their previous companies. The fact that we have assembled a full team with strong experience in all disciplines, from concept to execution, is a definite competitive advantage for Breaker. These people have made a full time commitment to Breaker and a large investment in its future; their sole aim is to build shareholder value.

Achievements

Despite our short history, Breaker has accomplished much toward building a solid platform for growth in production, reserves and value. Highlights include:

- Raised $1.0 million in private equity.

This team has a proven track record in implementing business strategies, creating significant reserves, production and value growth.

- Closed an Initial Public Offering of $10,000,000 on October 27, 2004 and began trading on the TSX Venture Exchange on November 2, 2004 under the symbols WAV.A and WAV.B.
- Announced two strategic farm-in agreements in our southern focus area, providing access to more than 165,000 net acres – over six townships of land.
- Acquired one private company and completed two asset acquisitions involving high quality, long-life natural gas and light oil reserves in southeast and northwest Alberta.

Management Team

The management team is primarily comprised of professionals that worked together in various capacities at AEC/EnCana. The team has extensive experience in all geologic horizons in the Western Canada Sedimentary Basin and is capable of competing in any area where Breaker chooses to do business. I am personally excited with our team's momentum and the opportunity we have created in such a short period of time.

- Closed two bought-deal private placements for gross proceeds of over $23 million to finance the acquisitions.
- Executed 95 percent of its winter program despite an extremely competitive winter for services, coupled with warm winter conditions. This consisted of drilling nine confidential exploratory wells, shooting, processing and interpreting of 135 square kilometres of 3-D seismic and the recompletion of seven wells. Seven of the exploratory wells were cased and two were dry holes.
- Current production of approximately 750 boe per day consists of 65 percent natural gas and 35 percent medium to light crude oil (26° to 37° API).
- As a result of the three acquisitions, Breaker currently has a reserve life index of approximately seven years based on independently audited proved plus probable reserves.
- The Company currently has access to a land base of more than 300,000 net acres in western Canada.

Outlook

Breaker's prospects for continued per share growth in reserves and production are excellent. After only a few months of operations the Company has positioned itself with a long-life base of operated, high working-interest natural gas and light oil reserves and production. The Company has access to more than 300,000 net acres that provide excellent exploration and development potential. The team has initially identified over 50 high-grade exploration and development drilling opportunities on this significant land base.

Breaker's guidance for 2005 includes capital expenditures of approximately $39 million, which will generate estimated average production of 850 boe per day, a year-end target exit rate of 1,225 boe per day and cash flow of approximately $6.3 million. The capital budget and cash flow are based on forecast commodity prices of US$39.50 per barrel of West Texas Intermediate (WTI) crude oil and US$6.38 per mmbtu for natural gas.

Acknowledgements

Our achievements to date represent the combined efforts and commitment of the Breaker team, with the support of our Board of Directors. I am grateful to both groups as well as the many investors who have joined us since our inception. We look forward to a period of strong growth and value creation.

On behalf of the Board of Directors,

Dan O'Neil
President and Chief Executive Officer
March 31, 2005

Exploration and Operations Review

Breaker Energy established two focus areas with a significant undeveloped land base and high working-interests where we are able to operate most of the drilling projects we undertake. Management has the experience to generate drilling prospects, supplemented by acquisitions with exploration, exploitation and development upside.

HIGH PRAIRIE FOCUS AREA

Breaker owns 81,000 net acres of undeveloped land in the High Prairie area of northwest Alberta, with an average working-interest greater than 85 percent. The area is comprised of two properties, Girouxville and East Prairie, with abundant available Crown land in between.

SOUTHERN FOCUS AREA

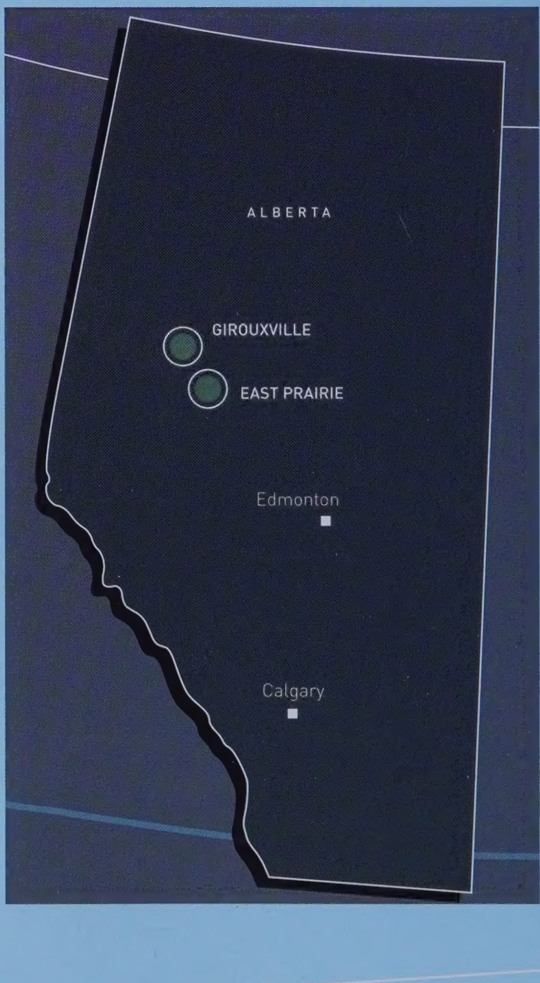
Breaker has access to more than 198,000 net acres of land through two major farm-ins at Suffield and Medicine Hat, land sale activity and the acquisition of the Provost property which has production of 370 boe per day.

High Prairie Focus Area

Breaker Energy has established a significant position in the High Prairie focus area through two separate acquisitions. In December 2004, the Company acquired a light oil (37° API) asset at Girouxville, producing approximately 230 barrels per day and approximately 60 percent operated. Subsequently, Breaker purchased a private company in January 2005 which was producing approximately 420 mcf per day of natural gas. The transaction offered significant access to petroleum and natural gas rights under the East Prairie Métis Settlement lands.

The High Prairie assets were acquired for $11.46 per boe of proved plus probable reserves or $20,857 per producing boe. This is based on a $9.9 million purchase price, which included $3.6 million attributed to land and seismic. The assets have been independently audited and assigned proved plus probable reserves of 545.9 mboe under NI 51-101 reserve disclosure requirements.

These acquisitions give Breaker access to more than 81,000 net acres of land with significant upside identified by our technical team. Equally important, Breaker operates the majority of the acreage and has access to Company-owned and third-party infrastructure with significant excess capacity.

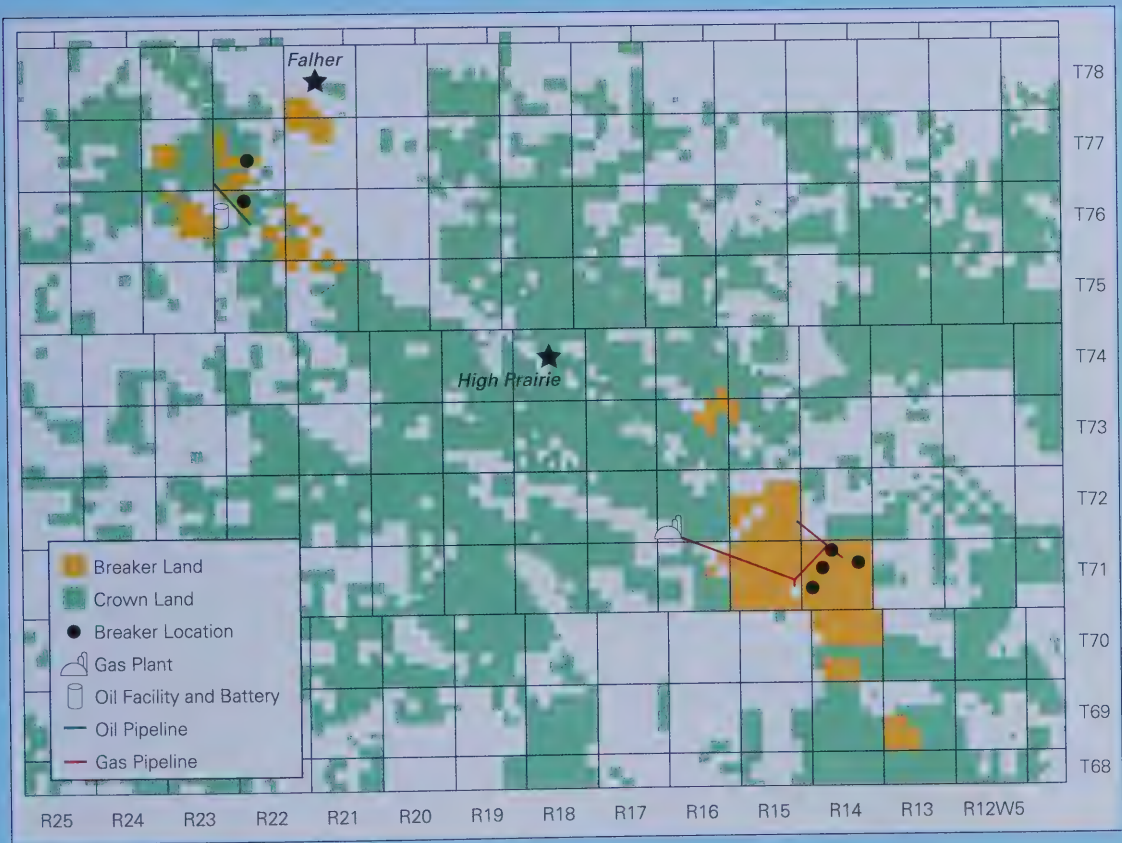


FOCUS AREA SUMMARY

Exploration Lands	105,000 (gross acres) 81,000 (net acres)
Seismic Database	2-D: 356 km 3-D: 132 sq. km
Zones Targeted	Viking, Falher, Bluesky, Gething, Triassic Gas, Beaverhill Lake, Gilwood Oil

2005 Focus

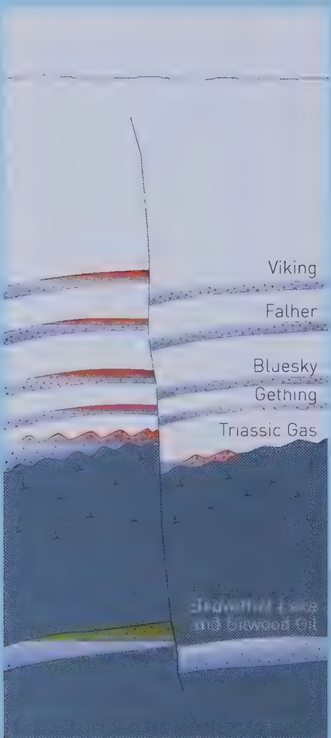
- Drilled 4 exploratory wells in Q1
- Recompleted 7 wells in Q1
- 5 wells planned for the remainder of 2005, targeting natural gas and light oil
- Reduce operating costs through ongoing field optimization



Girouxville

The Girouxville lands are located northwest of High Prairie. The lands consist of high working-interest and operated Beaverhill Lake and Gilwood production, as well as lower working-interest production, non-operated production and high working-interest undeveloped land. The area is accessible year-round. Breaker owns 11,000 net acres of undeveloped land at Girouxville. The majority of the rights are held to the base of the Beaverhill Lake and Gilwood formations, which are the deepest producing zones in the area.

High Prairie Area Geological Diagram



This figure illustrates the multi-zone nature of the High Prairie area and the types of prospects that occur in the area.

Production from the Beaverhill Lake and Gilwood formations is characterized mainly by high quality, 37° API oil and a small amount of natural gas and liquids. The operated pools include the Girouxville BHL B, C and I pools as well as the Gilwood F, I and M pools. Non-operated production comes from the Normandville BHL C, D, F, G and I pools. Reservoir quality is very good with porosities ranging from 9-17 percent and permeabilities that can exceed 5 Darcies. Due to structural complexities in the region, locations are usually selected with 3-D seismic in order to identify optimum settings. Breaker has access to 75 kilometres of 2-D and 112 square kilometres of 3-D seismic, and has initially identified three high-impact exploratory drill locations, as well as potential development locations on existing pools.

Breaker operates 60 percent of the oil production from the area. The operated production comes from the 100 percent owned battery at 12-28-76-22W5 which currently has excess capacity to accommodate future drilling in the area. Projects are underway to increase the efficiency of the battery and reduce operating costs. For example, Breaker retrofit a generator which will allow the burning of solution gas, rather than incineration. This initiative is expected to reduce power costs by as much as $5,000 per month.

Breaker plans to drill a minimum of three wells over the next 24 months. In addition to new drilling, the Company is designing an expansion of the existing waterflood to increase production and reserve recovery.

East Prairie

The acquisition of a private company in January 2005 provided Breaker with approximately 70,000 net acres of multi-zone petroleum and natural gas rights centred on the East Prairie Métis Settlement. The Settlement is located east of the town of High Prairie and is a combination of all-season and winter-only access areas.

There are several shallow Cretaceous-aged target zones identified and producing on the Settlement lands. Reservoir quality is generally quite good and completed wells are delivering economic rates of production without fracture stimulation. However, most zones do have underlying water which must be taken into account when planning completions and production practices. Optimum locations are typically found through seismic interpretation to identify structural highs and to minimize the risk of producing water. Breaker has access to 281 kilometres of 2-D and 20 square kilometres of 3-D seismic to aid in selecting well locations.

To date, sweet natural gas production has come from the Viking, Base Fish Scales, Notikewan and Falher zones. Slightly sour gas (500 ppm) is currently being produced from the Bluesky and Gething formations. Medium-gravity oil has been tested from the Viking formation. The land base has numerous exciting exploration and development opportunities which Breaker is currently evaluating.

Breaker has a 75 percent operated working-interest in the producing lands on the Settlement, with the remaining 25 percent owned by the Métis General Council and the East Prairie Métis Settlement. Infrastructure is owned by either Breaker or AltaGas. AltaGas owns and operates the Prairie River gas plant, which has excess capacity and provides custom processing for the East Prairie gas production. Breaker recently upgraded the field sour gas treating facilities from liquid scavenger injection to a solid dessicant system, which reduced total operating costs by approximately 50 percent. The Company is also considering field compression to handle additional volumes.

Breaker has also undertaken a number of well optimization initiatives, including three workovers and two reactivations with further low-risk upside identified in two additional wellbores.

In addition to optimization, Breaker has drilled three wells in Q1 2005, all within three miles of tie-in. Breaker expects to tie-in these wells before year end. A follow-up drilling program will occur later in the year in summer-accessible areas, with any further success to be followed up next winter. Well depths range from 700-1,200 metres and cost approximately $250,000 to $400,000 to drill.

Southern Focus Area

Breaker has access to approximately 198,000 net acres of undeveloped land within its Southern focus area. Breaker gained access to several large opportunities through two strategic area farm-ins in Q4 2004 and the purchase of the Provost property in Q1 2005. Independently audited proved plus probable reserves at Provost at the time of purchase totaled more than 1.5 million boe. The acquisition cost was $14.15 million. Breaker also purchased a 7 mmcf per day natural gas plant for $2.5 million. Opportunities at Provost include medium-risk exploration similar to the farm-in areas, in addition to a significant "resource play" development in the Viking Sand.

The area offers shallow, multi-zone drilling targets that are low cost and accessible year-round. Well depths range from 600 to 1,000 metres, with drilling costs of $110,000 to $250,000 per well. Wells will be targeted using mostly proprietary seismic, including 176 square kilometres of 3-D and 456 kilometres of 2-D. Targets include long-life tight gas in the Viking formation; multi-zone horizons with natural gas, medium and heavy oil in the Mannville formation; and additional deeper, higher-risk exploratory targets. Breaker has excellent access to infrastructure which is either operated by the Company or its farm-in partners. Breaker operates its drilling program and has high working interests in all areas.

FOCUS AREA SUMMARY

Exploration Lands	209,000 (gross acres) 198,000 (net acres)
Seismic Database	2-D: 456 km 3-D: 176 sq. km
Zones Targeted	Viking/Bow Island, Colony, McLaren, Sparky, Glauconitic, Dina/Basal Quartz, Nisku

2005 Focus

- Completed a 64 square kilometre 3-D seismic program in Medicine Hat area in Q1; first 6 wells planned to spud in Q2
- Drilled first 5 wells in Suffield in Q1; follow up drilling throughout the year
- Viking tight gas development at Provost to commence in Q3 with first 10-well project; follow up drilling later in the year

Provost, South-Central Alberta

Acquired in February 2005, Provost is a concentrated, long reserve life, high working-interest asset. The asset is operated with an average working-interest of 80 percent. It is further characterized by having all-season access, Breaker ownership of the gas gathering and processing infrastructure, and shallow to medium-depth, multi-zone development and exploration opportunities.

Provost Area Geological Diagram

This figure illustrates the multi-zone nature of the Provost area and the types of prospects that occur in the area.

The Provost acquisition included approximately 12,000 net acres of undeveloped land, which is prospective from multiple Cretaceous-aged sands.

The asset has extensive gas infrastructure which includes an operated gas plant with approximately 7 mmcf per day of capacity and 51 kilometres of gathering and sales pipeline infrastructure.

At the time of purchase, independent reserve evaluators estimated the asset had proved plus probable reserves of 1.5 million barrels of oil equivalent. Based on the acquired production rate of 370 barrels of oil equivalent per day, this yields a reserve life index of 11.3 years.

Current production is approximately 95 percent sweet gas and 5 percent medium gravity oil (26° API).

Current gas production is from the Viking Sand and deeper Mannville sands including the Colony, Sparky and Rex.Drilling depths range from 700 to 900 metres.

Gas production from the Viking is characterized as having large reserves in place, continuity of lateral extension of producing sands, relatively low initial gas production rates, very little associated water production and a very long reserve life.

Breaker views the Viking as a "resource play", which can be increased in size with the implementation of careful cost control and application of new, innovative technology. With the successful implementation of these processes, Breaker estimates the Viking gas resource potential on its lands could be significantly larger than the current independent reserve bookings.

Current development of the Viking within the Breaker lands is at one to two wells per section. Downspacing approval has been obtained from the AEUB to drill four wells per section on 16 sections of land operated by Breaker. Operators on adjacent acreage have applied for downspacing for up to nine wells per section which is currently under review by the AEUB. Based on nine wells per section, Breaker could drill over 100 wells on its Provost lands.

Gas is also a target in the Mannville group. Reservoirs are characterized as having high initial deliverability, relatively high decline rates and complex geological settings which form local traps.

Breaker forecasts further development in 2005 with 20-25 wells targeting the Viking formation. It is anticipated that a progressively larger proportion of production will come from the Viking in the future, providing a long-term, stable production base.

Current medium-gravity (26° API) oil production is from two wells which are completed in the Sparky sand. The wells are both producing under primary recovery, with solution gas being the dominant drive mechanism. Little associated water has been produced from the wells to date.

Development of Provost will be facilitated by proprietary seismic data that was included in the purchase. This is comprised of 42 square kilometres of 3-D and 92 kilometres of 2-D data.

Suffield Military Range Farm-In

This sizable farm-in provides Breaker with access to approximately 50,000 net acres of land and 280 kilometres of proprietary 2-D seismic in an area of southern Alberta previously dominated by a large independent producer. The farm-in is situated just a few townships north of the Medicine Hat area farm-in.

Suffield Area Geological Diagram

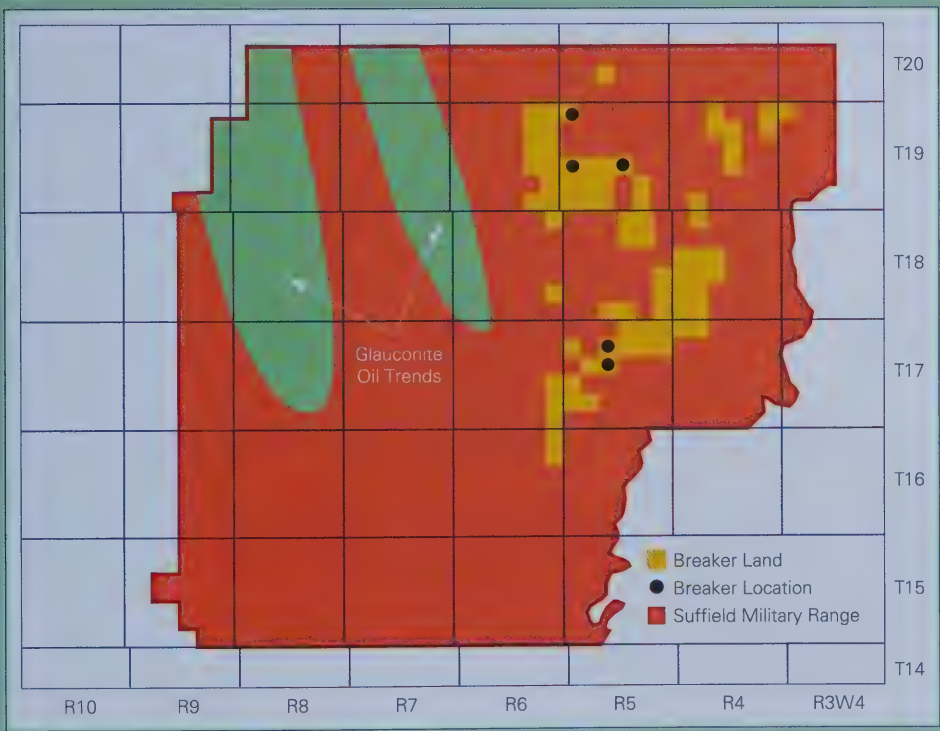
This figure illustrates the multi-zone nature of the Suffield area and the types of prospects that occur in the area.

Breaker's option includes earning a 60 percent interest, with pay-out on each section drilled, earning rights below the top of the Mannville formation. The majority of the surrounding acreage is open Crown land in Breaker's target zones, providing excellent "running room" for following up successful drilling. Until early 2000, the Suffield Military Range was not accessible to most companies. Consequently, the lands Breaker has under option have not been heavily explored by industry. Surface access is good, with mainly dry rolling prairie; however, access is limited typically between May and October due to short periods of military exercises.

The medium to high-risk targets are sweet gas and heavy oil in the Mannville formation, including the very prolific Glauconitic member at approximately 900 metres depth and light (34° API) sour oil in the Nisku/Arcs formation. Both play types are well suited to 3-D seismic, which has led to significant recent developments nearby. Initial rates of successful wells can range from 20-200 boe per day.

Breaker has access to the farmor's extensive infrastructure for both oil and gas processing. As a result of surface access timing and the higher-risk nature of the target zones, Breaker has not budgeted any production from the Suffield area in 2005.

In the fourth quarter of 2004, Breaker shot and processed two 3-D seismic programs totaling 70 square kilometres. The Company has drilled five initial wells in the first quarter of 2005 and will have a continuing option to drill on the remaining farm-in lands.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Glauconite
Oil Trends
Breaker Land
Breaker Location
Suffield Military Range

Medicine Hat Area Farm-In

This strategic farm-in provides access to approximately 115,000 net acres of land and abundant infrastructure in one of the most accessible, multi-zone areas of Alberta, located a few townships south of the Suffield area farm-in.

The Medicine Hat area has been producing natural gas for over 100 years, due to shallow zones, proximity to markets and significant resource base. Breaker has an option on over four townships of land in the Medicine Hat area, including most rights held below the Base Fish Scales. This area has seen very little seismically-driven exploration. Breaker earns a 100 percent interest in each section drilled, subject to a gross overriding royalty payable to the farmor. Surface access is all-season. Rolling, dry, treeless pasture provides some of the best terrain in western Canada for shooting seismic and drilling.

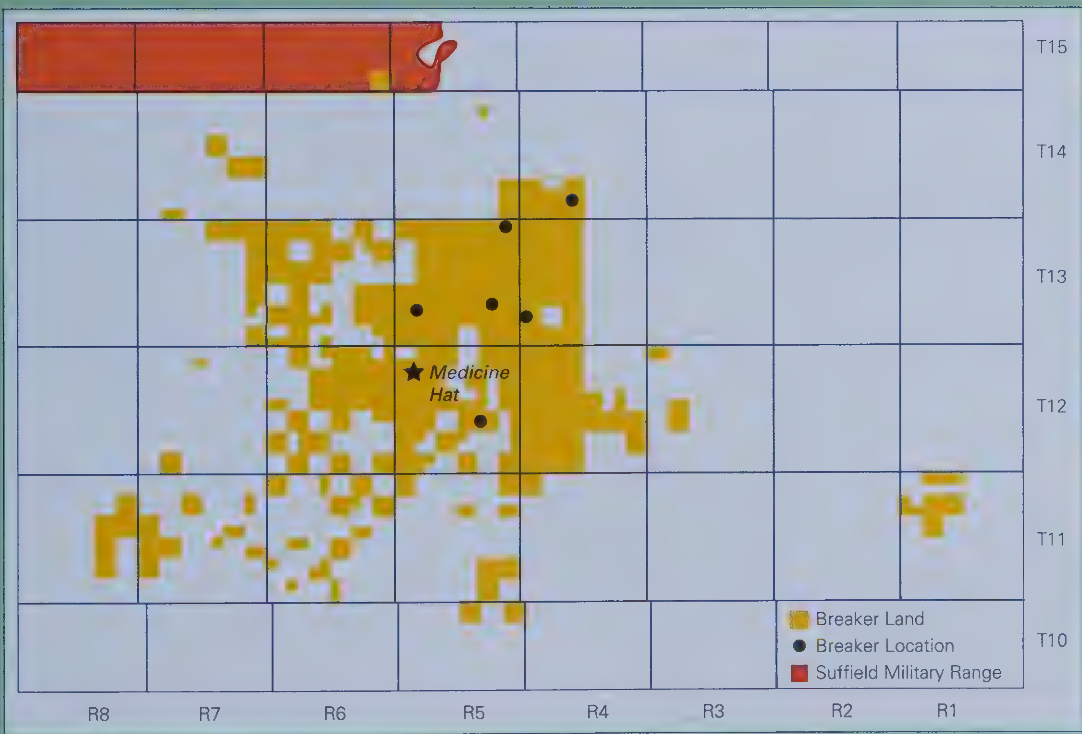
The target zones are shallow, low-to-medium risk, multi-zone sands in the Cretaceous, with the possibility of higher-impact, deeper zones. The main targets include gas in the Bow Island and related sands (approximately 650 metres) and gas and oil in the Mannville, including the prolific Glauconitic member (approximately 875 metres). Successful wells have typical production rates of 50-500 mcfe per day.

Breaker has access to the farmor's extensive shallow gas infrastructure and as a result the vast majority of wells will be less than 0.5 kilometres from tie-in.

Breaker completed a 64 square kilometre 3-D seismic program in January 2005 and will drill six initial wells in the second quarter, with follow-up drilling planned for the fall.

Medicine Hat Area Geological Diagram

This figure illustrates the multi-zone nature of the Medicine Hat area and the types of prospects that occur in the area.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T12
T11
T10
Medicine Hat
Breaker Land
Breaker Location
Suffield Military Range
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R7
R6
R5
R4
R3
R2
R1

Period from incorporation on March 8, 2004 to December 31, 2004.

For a full understanding of the financial position and results of operations of Breaker Energy Ltd., ("Breaker" or "Company"), this Management's Discussion and Analysis (MD&A) of financial conditions and results of operations should be read in conjunction with the financial statements and related notes for the period from incorporation on March 8, 2004 to December 31, 2004.

Breaker was incorporated on March 8, 2004; therefore, no comparative information exists. Prior to the initial public offering, Breaker had limited oil and natural gas operations. In the fourth quarter of 2004, Breaker entered into farm-in agreements and acquired assets that established a production base and provided the opportunity to commence its drilling program.

All amounts are expressed in Canadian dollars. Petroleum and natural gas reserves and volumes are converted to a common unit of measure, referred to as a barrel of oil equivalent (boe), on the basis of 6,000 cubic feet of natural gas equals one barrel. This conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. It should be noted that boes may be misleading, particularly if used in isolation. The term boe per day (boed) has been used throughout this MD&A.

The terms "cash flow from operations", "cash flow", "cash flow per share" and "debt-to-cash-flow ratio" in this discussion are not recognized measures under Canadian Generally Accepted Accounting Principles (GAAP). Management believes that in addition to net earnings, cash flow is a useful supplemental measure as it provides an indication of the results generated by the Company's principal business activities before the consideration of how those activities are financed or how the results are taxed. Investors are cautioned, however, that this measure should not be construed as an alternative to net earnings determined in accordance with GAAP, as an indication of Breaker's performance.

Breaker's method of calculating cash flow may differ from other companies, and accordingly it may not be comparable to measures used by other companies. Breaker calculates cash flow from operations as "funds from operations" before the change in non-cash working capital related to operating activities. In addition, the terms "cash flow" and "funds from" are used interchangeably. The statements of cash flows in the financial statements present the reconciliation between earnings and cash flow.

Forward-Looking Statements

Statements in this document may contain forward-looking information. Estimates provided for 2005 and beyond are based on assumptions of future events and actual results could vary significantly from these estimates. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. Events or circumstances may cause actual results to differ materially from those predicted as a result of numerous known and unknown risks, uncertainties, and other factors, many of which are beyond the control of the Company. The reader is cautioned not to place undue reliance on this forward-looking information.

This MD&A is dated as of April 4, 2005.

2004 Overview

In 2004, Breaker built an opportunity base of more than 300,000 net acres of land through strategic farm-ins in its Southern focus area and acquisitions which included 81,000 net acres of land in its High Prairie focus area. On December 22, 2004 the Company closed the acquisition of approximately 230 barrels per day of light oil production

in its High Prairie focus area for cash consideration of $6.9 million. Breaker financed the acquisition with proceeds from a $10.0 private placement of Class A shares that closed the same day.

Breaker also commenced shooting 3-D seismic in 2004 as a part of its farm-in commitments and exploration program. This included a 34 square kilometre 3-D seismic program in the North Suffield area; a 31 square kilometre 3-D seismic program in the South Suffield area and a 67 square kilometre 3-D seismic program in the Medicine Hat area, all of which were completed in January 2005.

2005 Year-to-Date Activities

High Prairie Focus Area

On January 20, 2005 Breaker acquired approximately 420 mcf per day of natural gas production in its High Prairie focus area through the acquisition of a private oil and gas company. As consideration, the Company issued 451,836 Class A shares and paid cash of $755,000.

Southern Focus Area

On February 25, 2005 Breaker acquired approximately 370 boe per day in the Provost area of Alberta for $14.15 million and a 7.0 mmcf per day natural gas plant for $2.5 million for total gross proceeds before adjustments of $16.65 million. The concentrated, high working-interest property is operated, accessible year-round and at the time of purchase had production of approximately 2.1 mmcf per day of natural gas and 20 barrels per day of medium crude. Breaker completed a private placement for gross proceeds of $13.2 million on the same day and used the proceeds to fund the acquisition. The private placement consisted of 3,490,000 Class A shares at an issue price of $2.90 and 870,000 Class A flow-through shares at an issue price of $3.50.

Production

Breaker exited the year at approximately 220 barrels per day of light oil production and 5 mcf per day of natural gas production. Breaker's average production in 2004 was 5 boe per day, as all of its production resulted from the property acquisition that closed on December 22, 2004.

Petroleum, Natural Gas and Other Revenues

Revenues for 2004 were $145,714, which includes $98,898 from oil and natural gas sales resulting from the nine days of production following the closing of the property acquisition on December 22, 2004. The average price received for the production was $49.75 per boe. Breaker did not enter into any commodity or currency hedges in 2004 or during the early part of 2005.

Interest income of $46,816 was recognized during the period from cash on deposit as a result of the initial public offering and private placement during 2004.

Royalties

Royalty costs in 2004 were $17,390, or 17.6 percent of sales. Based on the acquisitions completed as of the date of the MD&A and forecast drilling results, Breaker expects that the corporate royalty rate will be in the 20-25 percent range for 2005.

Operating Expenses

Operating costs were $47,236 or $23.76 per boe for the short nine-day period in 2004. The acquired property required some major service work in the fourth quarter which increased operating costs significantly. Operating

costs on the acquired property for the nine months of 2004 prior to the acquisition were $15.04 per boe, which is in line with management expectations.

Breaker now forecasts corporate average full year operating costs for 2005 will be in the range of $10.00 to $12.00 per boe, as higher volumes, the acquisition of lower cost properties and cost savings measures are anticipated to offset generally rising costs.

General and Administrative Expenses

General and administrative expenses (G&A) for 2004 were $202,255 after overhead recoveries of $39,392 and amounts capitalized of $151,180. Breaker capitalized 38 percent of its G&A in 2004 based on an analysis of costs directly related to exploration activities. Salaries, insurance, software rental, audit fees, legal fees and consulting services comprised approximately 75 percent of the gross administrative costs.

Stock-Based Compensation

Breaker recorded stock-based compensation expense of $7,034 in 2004 based on a weighted average fair value of $0.13 per option, calculated using the Black-Scholes option pricing model. The following assumptions were used to calculate stock-based compensation in 2004: zero dividend yield; expected volatility of 33 percent; risk-free rate of four percent; and expected life of five years. The remaining expense of $106,234 will continue to be expensed through future earnings over the vesting period of the options.

Depletion, Depreciation and Accretion

Depletion and depreciation are calculated based upon capital expenditures, production rates and reserves. Breaker recorded $48,955 in depletion and depreciation for the period ended December 31, 2004 based on production volumes of 1,988 boe. The Company excluded from its depletion and depreciation calculation, costs associated with unproven properties and seismic of $6.3 million. The Company also conducted a ceiling test as of December 31, 2004 with no write-down required.

Breaker uses the asset retirement obligation method to record the present value of estimated clean-up and restoration costs for all of its facilities, including well sites and pipelines. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Breaker recorded $3,000 of accretion expense in 2004 with a $2.0 million liability recognized on the balance sheet.

Income and Other Taxes

Breaker renounced $10.0 million effective December 31, 2004 as a result of the flow-through obligations associated with the Class A and Class B flow-through shares issued on the initial public offering in October 2004. With budgeted expenditures of $38.8 million in 2005, Breaker expects that it will have sufficient tax pools to offset its 2005 current tax liability. Of the budgeted capital, $8.1 million will have no associated tax pools as this represents the unexpended December 31, 2004 balance related to the flow-through share offering. Breaker issued an additional $3.0 million of flow-through shares on February 25, 2005. Taxes payable beyond 2005 will be a function of commodity prices, production volumes and capital expenditures.

The provision for income taxes differs from the amount obtained by applying the combined Federal and Provincial income tax rate of 2004 – 38.6 percent to income before income taxes, mainly due to non-deductible Crown charges and resource allowance.

The tax impact of the flow-through shares issued in 2004 will be booked in the first quarter of 2005 when the expenditures were renounced to investors.

The Company pays interest to the government on flow-through funds renounced in 2004 that remain unexpended at the end of each month in 2005. On January 1, 2005 Breaker had $8.1 million in unspent qualifying expenditures and will commence paying interest at prescribed rates beginning in February 2005.

Estimated Tax Pools

The table below presents Breaker's estimated tax pools, net of the $1.9 million related to flow-through share obligations that was incurred in 2004.

($ thousands)	Dec. 31, 2004	Rate of Claim (%)
Canadian exploration expense	273	100
Non-capital loss	423	100
Canadian development expense	–	30
UCC	1,529	20-100
Share issue	1,180	20
Canadian oil and natural gas property expense	5,863	10
Total	9,268	

Quarterly Data, Net Loss and Funds Used in Operations

2004	Q4	Q3	Q2	Q1
Total revenue (000s)	141.3	2.6	1.8	–
Net loss (000s)	(111.9)	(45.9)	(22.4)	–
Net loss per basic and diluted share	$ (0.01)	$ (0.02)	$ (0.01)	–

Breaker incurred a loss of $180,156 or $0.04 per basic and diluted share in 2004 due to G&A costs being incurred for the entire period since incorporation. Net production revenue, however, was only recognized for the nine-day period following closing of the property acquisition on December 22, 2004. For similar reasons, Breaker used funds in operations of $121,167 or $0.03 per basic and diluted share.

Capital Expenditures

Breaker expended $6.9 million on the asset acquisitions in the High Prairie focus area in 2004 and assumed asset retirement obligations of $2.0 million. Another $2.0 million was spent on seismic and $0.4 million on land. Breaker acquired 137,390 net acres of undeveloped land in 2004 through acquisitions and at Crown land sales.

Breaker has an estimated 2005 capital program of $38.8 million, of which $6.3 million is forecast to be funded through cash flow, and the balance from the banking facility and working capital.

Equity

Prior to going public, Breaker issued 4,000,001 Class A shares for total gross proceeds of $1.0 million.

On October 27, 2004 Breaker closed its initial public offering, issuing 4,000,000 Class A flow-through shares and 900,000 Class B flow-through shares for total gross proceeds of $10.0 million.

Breaker's shares were listed on the Venture Stock Exchange on November 2, 2004 under the symbols WAV.A for the Class A shares and WAV.B for the Class B shares.

On December 22, 2004 Breaker completed a private placement for 3,850,000 Class A shares at an issue price of $2.60, for total gross proceeds of $10.0 million.

On February 25, 2005 Breaker completed a $13.2 million private placement issuing 3,490,000 Class A shares at an issue price of $2.90 and 870,000 Class A flow-through shares at an issue price of $3.50.

The Class B shares are convertible into Class A shares at the option of the Company at any time after September 1, 2007 and before September 1, 2009. The fraction is calculated by dividing $10 by the greater of $1 and the then-current market price of Class A shares. If conversion has not occurred by the close of business on September 1, 2009, the Class B shares become convertible at the option of the shareholder into Class A shares on the same basis. Effective October 2, 2009, all remaining Class B shares will automatically convert to Class A shares.

Share Capital

	2004
Weighted Class A shares	3,683,860
Weighted Class B shares	196,309
Conversion of Class B shares – weighted	604,027
Basic and diluted shares outstanding*	4,287,886

* For December 31, 2004 the Class B shares are converted at the year-end Class A share price of $3.25 and added to the Class A shares to calculate basic shares outstanding. In computing the diluted loss per share, 890,000 options were excluded from the dilution calculation as they were anti-dilutive.

At year-end 2004, Breaker had 11,850,001 Class A shares and 900,000 Class B shares outstanding.

During 2004, the Company granted 890,000 Class A stock options at $0.35 per share to employees of the Company. Subsequent to December 31, 2004 Breaker has granted 355,000 stock options at a price of $3.45 per share.

At April 4, 2005 the Company has 16,661,837 Class A shares, 900,000 Class B shares and 1,245,000 options outstanding.

Liquidity and Capital Resources

At December 31, 2004 the Company had working capital of $9.7 million, including cash of $11.6 million. At the date of this MD&A, the Company has a $9.0 million revolving credit facility with a Canadian chartered bank with no amounts drawn. Breaker expects to be in a net debt position at the end of 2005.

Breaker anticipates that future capital requirements will be funded through a combination of internal cash flow, debt and/or equity financing. There is no assurance that debt and equity financing will be available on terms acceptable to the Company to meet its capital requirements.

Related Party and Off-Balance Sheet Transactions

Breaker was not involved in any off-balance sheet transactions during the year.

The Company provides technical and administrative support for the oil and natural gas operations of two companies, of which a director and officer is also a director of Breaker. At year end, the Company was owed $150,943 from the

related companies for management fees, administrative recoveries and capital expenditures. These transactions are in the normal course of operations and are measured at the exchange amount established and agreed upon by the related parties.

On January 22, 2005 the Company acquired all of the issued and outstanding shares of East Prairie Exploration Ltd., a private oil and gas company, of which a director and officer is also a director of Breaker. As consideration, the Company issued 451,836 Class A common shares and paid cash of $755,000.

Commitments

The Company has entered into farm-in agreements in the normal course of its business.

Breaker has future minimum lease payments on office space of $36,908 in 2005 and $23,849 in 2006.

The Company renounced $10.0 million of qualified expenditures, effective December 31, 2004 and incurred $1.9 million prior to that date. Breaker has until December 31, 2005 to expend $8.1 million on the remaining qualified expenditures.

Risk Factors

Risk factors can be found under the heading "Risk Factors" in the Company's Prospectus dated October 15, 2004.

Critical Accounting Estimates

Proved Oil and Gas Reserves

Under National Instrument 51-101 (NI 51-101), "proved" reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. In accordance with this definition, the level of certainty targeted by the reporting company should result in at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated reserves. In the case of "probable" reserves, which are less certain to be recovered than proved reserves, NI 51-101 states that it must be equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves. With respect to the consideration of certainty, in order to report reserves as proved plus probable, the reporting company must believe that there is at least a 50 percent probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves. The implementation of NI 51-101 has resulted in a more rigorous and uniform standardization of reserve evaluation.

The oil and gas reserve estimates are made using all available geological and reservoir data as well as historical production data. Estimates are reviewed and revised as appropriate. Revisions occur as a result of changes in prices, costs, fiscal regimes, reservoir performance or a change in the Company's plans. The effect of changes in proved oil and gas reserves on the financial results and position of the Company is described next under depletion expense and impairment of petroleum and natural gas properties.

Depletion Expense

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development are capitalized whether or not the activities funded were successful. The aggregate of net capitalized costs and estimated future development costs, less estimated salvage values, is amortized using the unit-of-production method based on estimated proved oil and gas reserves.

An increase in estimated proved oil and gas reserves would result in a corresponding reduction in depletion expense. A decrease in estimated future development costs would result in a corresponding reduction in depletion expense.

Withheld Costs

Certain costs related to unproved properties may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly and any impairment is transferred to the costs being depleted.

Impairment of Petroleum and Natural Gas Assets

The Company is required to review the carrying value of all petroleum and natural gas assets for potential impairment. Impairment is indicated if the carrying value of the petroleum and natural gas assets is not recoverable by the future undiscounted cash flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the property, plant and equipment is charged to earnings. The assessment of impairment is dependent on estimates of reserves, production rates, prices, future costs and other relevant assumptions.

Asset Retirement Obligations

The Company is required to provide for future removal and site restoration costs. The Company must estimate these costs in accordance with existing laws, contracts or other policies. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is expected to be incurred, discounted to its present value using the Company's four percent credit premium, added to the four percent risk-free interest rate and two percent inflation rate. The offset to the liability is recorded in the carrying amount of petroleum and natural gas properties. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

Stock-Based Compensation

The Company uses the fair value method for valuing stock option grants. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2004: zero dividend yield; expected volatility of 33 percent; risk-free rate of four percent; and expected life of five years.

Legal, Environmental Remediation and Other Contingent Matters

The Company is required to determine whether a loss is probable based on judgement and interpretation of laws and regulations and whether the loss can reasonably be estimated. When the loss is determined, it is charged to earnings.

The Company's management must continually monitor known and potential contingent matters and make appropriate provisions by charges to earnings when warranted by circumstance.

Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Management's Report to Shareholders

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial operating data contained elsewhere in the report. In the preparation of these statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgements and have been properly reflected. The financial statements have been prepared using policies and procedures established by management and reflect fairly Breaker's financial position, results of operations and cash flow.

Management has established and maintains a system of internal controls which are designed to ensure that financial information is reliable and accurate and to provide assurance that assets are safeguarded from loss or unauthorized use.

KPMG LLP, independent auditors appointed by the shareholders, has examined the consolidated financial statements and Gilbert Laustsen Jung Associates Ltd. have reviewed the Company's reserves. Their examination provides an independent view as to the amounts and disclosures in the financial statements.

The Board of Directors has reviewed in detail the financial statements with management and the external auditors. The Board of Directors has approved the financial statements as presented in this annual report.

P. Daniel O'Neil
President and Chief Executive Officer

Max Lof
Vice President, Finance and Chief Financial Officer

Auditors' Report to the Shareholders

We have audited the balance sheet of Breaker Energy Ltd. as at December 31, 2004 and the statements of operations and deficit and cash flows for the period from incorporation on March 8, 2004 to December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and its cash flows for the period from incorporation on March 8, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

KPMG LLP
Chartered Accountants
Calgary, Canada
April 4, 2005

Balance Sheet

December 31, 2004	
ASSETS	
Current assets:	
Cash and cash equivalents	$ 11,594,107
Accounts receivable	204,863
Prepaid expenses and deposits	209,348
Due from related parties (note 9)	150,943
	12,159,261
Petroleum and natural gas properties (note 3)	11,673,137
	$ 23,832,398
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Accounts payable and accrued liabilities	$ 2,429,534
Asset retirement obligations (note 4)	1,975,488
Shareholders' equity:	
Share capital (note 6)	19,600,498
Contributed surplus (note 6)	7,034
Deficit	(180,156)
	19,427,376
Commitments (note 10)	
Subsequent events (notes 6 and 12)	
	$ 23,832,398

See accompanying notes to financial statements.

On behalf of the Board:

Robert Leach
Director

Peter Bannister
Director

Statement of Operations and Deficit

	Period from Incorporation on March 8, 2004 to December 31, 2004
REVENUES:	
Petroleum and natural gas	$ 98,898
Royalties	(17,390)
Other income	46,816
	128,324
EXPENSES:	
Operating	47,236
General and administrative	202,255
Stock-based compensation	7,034
Depletion, depreciation and accretion	51,955
	308,480
Net loss, being deficit end of period	$ (180,156)
Loss per share (note 6):	
Basic	$ (0.04)
Diluted	$ (0.04)

See accompanying notes to financial statements.

Statement of Cash Flows

	Period from Incorporation on March 8, 2004 to December 31, 2004
CASH PROVIDED BY (USED IN):	
Operations:	
Net loss	$ (180,156)
Items not involving cash:	
Depletion, depreciation and accretion	51,955
Stock-based compensation	7,034
Funds used in operations	(121,167)
Change in non-cash working capital (note 8)	(322,539)
	(443,706)
Financing:	
Issue of common shares	21,010,000
Share issue costs	(1,409,502)
Change in non-cash working capital (note 8)	40,000
	19,640,498
Investments:	
Petroleum and natural gas properties	(9,749,604)
Change in non-cash working capital (note 8)	2,146,919
	(7,602,685)
Change in cash, being cash end of period	$ 11,594,107

Cash is defined as cash and cash equivalents.

See accompanying notes to financial statements.

Period from incorporation on March 8, 2004 to December 31, 2004

1. Incorporation

Breaker Energy Ltd. (the "Company") was incorporated under the laws of the Province of Alberta on March 8, 2004. The Company is engaged in the exploration for and development and production of oil and gas in western Canada.

2. Significant Accounting Policies

The financial statements include the accounts of the Company and have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the statements and accompanying notes. As a result, actual amounts could differ from estimated amounts.

Specifically, the amounts recorded for depletion and depreciation of petroleum and natural gas properties and the provision for asset retirement obligations and abandonment costs are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(a) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and all investments that are highly liquid in nature and have a maturity date of three months or less.

(b) Petroleum and natural gas properties

The Company follows the full cost method of accounting for oil and gas operations, whereby all costs of exploring for and developing oil and gas properties and related reserves are capitalized. Capitalized costs include land acquisition costs, cost of drilling both productive and non-productive wells, asset retirement costs, and geological and geophysical expenses and related overhead. Gains or losses on the disposition of oil and gas properties are not ordinarily recognized, except under circumstances which result in a change in the depletion rate of 20 percent or more.

Capitalized costs, excluding costs relating to unproven properties, are depleted using the unit-of-production method based on estimated proved reserves of oil and gas before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on the relative energy content of six thousand cubic feet of gas to one barrel of oil.

Costs of acquiring unproven properties are initially excluded from the full cost pool and are assessed at each reporting period to ascertain whether impairment has occurred. When proved reserves are assigned to the property or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the full cost pool.

Petroleum and natural gas properties are evaluated in each reporting period to determine that the carrying amount in a cost centre is recoverable and does not exceed the fair value of the properties in the cost centre.

The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproven properties and the cost of major development projects exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproven properties and the cost of major development projects of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Office equipment is recorded at cost and is depreciated on the declining balance basis using rates varying from 20-30 percent.

(c) Interest in joint ventures

Certain of the Company's oil and gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(d) Asset retirement obligations

The Company uses the asset retirement obligation method of recording the future cost associated with removal, site restoration and asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit-adjusted, risk-free interest rate and the corresponding amount is recognized by increasing the carrying amount of petroleum and natural gas properties. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(e) Future income taxes

The Company uses the asset and liability method of accounting for future income taxes. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets and liabilities. Future income tax assets or liabilities are calculated using the currently enacted or substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

(f) **Flow-through shares**

The Company will from time to time issue flow-through shares to finance a portion of its capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, share capital will be reduced and a future tax liability will be recorded equal to the estimated cost of the renounced tax deductions when the expenditures are renounced.

(g) **Stock-based compensation plans**

The Company uses the fair value method for valuing stock option grants. Under this method, compensation cost attributable to all share options granted is measured at fair value at the date of grant and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

(h) **Per share amounts**

Basic per share amounts are calculated using the weighted average number of Class A and Class B shares outstanding during the period. Class B shares are converted to Class A shares at $10, divided by the greater of $1 and the Class A share market price at the period-end. Diluted per share amounts are calculated based on the treasury stock method. The weighted average number of shares is adjusted for the dilutive effect of options. The dilutive effect of options uses proceeds received on the exercise of options plus the unamortized portion of stock-based compensation to purchase Class A shares at the average price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

(i) **Revenue recognition**

Petroleum and natural gas revenues are recognized when the title and risks pass to the purchaser.

3. Petroleum and Natural Gas Properties

	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	$ 11,722,092	$ 48,955	$ 11,673,137

On December 22, 2004 the Company acquired interests in certain petroleum and natural gas properties for consideration of $6,894,000.

During 2004, the Company capitalized $151,180 of overhead-related costs to petroleum and natural gas properties.

Costs associated with unproven properties and seismic excluded from costs subject to depletion for 2004 totaled $6,295,000. Future development costs of proved reserves of $116,000 have been included in the depletion calculation.

At December 31, 2004 the Company applied a ceiling test to its petroleum and natural gas properties using expected future market prices of:

	WTI Oil (US$/bbl)	Foreign Exchange Rate	WTI Oil (Cdn$/bbl)	Breaker Oil (Cdn$/bbl)	AECO Gas (Cdn$/mmbtu)	Breaker Gas (Cdn$/mmbtu)
2005	$ 42.00	0.82	$ 51.24	$ 48.25	$ 6.60	$ 7.43
2006	40.00	0.82	48.80	45.75	6.35	7.14
2007	38.00	0.82	46.36	43.50	6.15	6.90
2008	36.00	0.82	43.92	41.25	6.00	6.73
2009	34.00	0.82	41.48	38.75	6.00	6.73

4. Asset Retirement Obligations

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas properties including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations is approximately $2,807,000 which will be incurred between 2005 and 2009. The majority of the costs will be incurred between 2006 and 2009. An inflation factor of two percent has been applied to the estimated asset retirement cost. A credit-adjusted, risk-free rate of eight percent was used to calculate the fair value of the asset retirement obligations. A reconciliation of the asset retirement obligations is provided below:

	2004
Balance, beginning of period	$ –
Liabilities incurred on acquisition	1,972,488
Accretion expense	3,000
Balance, end of period	$ 1,975,488

5. Bank Debt

The Company has a $9,000,000 demand revolving credit facility with a Canadian chartered bank bearing interest at bank prime rates plus 0.25 percent. The facility is secured by a first fixed and floating charge debenture in the minimum face amount of $20,000,000 and a general security agreement. No amounts were drawn on the facility as of December 31, 2004.

6. Share Capital

(a) Authorized

Unlimited number of voting Class A shares.

Unlimited number of Class B shares, convertible at the option of the Company at any time after September 1, 2007 and before September 1, 2009, into Class A shares. The fraction is calculated by dividing $10 by the greater of $1 and the then-current market price of Class A shares. If conversion has not occurred by the close of business on September 1, 2009, the Class B shares become convertible at the option of the shareholder into Class A shares on the same basis. Effective October 2, 2009, all remaining Class B shares will automatically be converted to Class A shares.

Unlimited series of Preferred Shares, terms and conditions to be set by the Board of Directors when issued.

(b) Issued:

	Number of Shares	Amount
Class A shares:		
Issued as initial capital	4,000,001	$ 1,000,000
Issued pursuant to flow-through public offering	4,000,000	1,000,000
Issued pursuant to private placement	3,850,000	10,010,000
Share issue costs	–	(1,409,502)
Balance, December 31, 2004	11,850,001	$ 10,600,498
Class B shares:		
Issued pursuant to flow-through public offering	900,000	$ 9,000,000
Balance, December 31, 2004	900,000	$ 9,000,000
Total share capital on December 31, 2004		$ 19,600,498

During the period from incorporation on March 8, 2004 to September 7, 2004, the Company raised initial capital of $1,000,000 consisting of 4,000,001 Class A common shares at $0.25 per share. On October 27, 2004 the Company completed its initial public offering issuing 4,000,000 Class A flow-through shares at $0.25 per share and 900,000 Class B flow-through shares at $10.00 per share for gross proceeds of $10,000,000. On December 22, 2004 the Company issued 3,850,000 Class A shares at $2.60 per share for gross proceeds of $10,010,000.

(c) Stock options

Under the Company's stock option plan it may grant options to its employees for up to 1,275,000 Class A shares of the Company. The exercise price of each option equals the market price of the Company's stock on the date of grant, with options having a term of five years to maturity and vesting as to one-third on each of the first, second and third anniversaries from the date of grant.

	2004	
	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of period	–	$ –
Granted	890,000	0.35
Stock options outstanding, end of period	890,000	$ 0.35
Exercisable at period-end	–	$ –

The following table summarizes information about the stock options outstanding at December 31, 2004:

	Options Outstanding			Options Exercisable	
Exercise Prices	Number Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Number Exercisable	Weighted Average Exercise Price
$0.35	890,000	$ 0.35	4.8	–	$ –

Subsequent to December 31, 2004, the Company issued 355,000 options at an exercise price of $3.45 to management, staff and directors.

(d) Stock-based compensation

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2004: zero dividend yield; expected volatility of 33 percent; risk-free rate of four percent; and expected life of five years. The weighted average fair value of stock options granted during the period was $0.13 per option.

The Company has not incorporated an estimated forfeiture rate for stock options that will not vest; rather, the Company accounts for actual forfeitures as they occur.

(e) Contributed surplus

	2004
Balance, beginning of period	$ –
Compensation expense	7,034
Balance, end of period	$ 7,034

(f) Per share amounts

Per share amounts have been calculated using the weighted average number of shares outstanding. The weighted average shares outstanding for the period from incorporation on March 8, 2004 to December 31, 2004 were 4,287,886. In computing the diluted loss per share, 890,000 options were excluded from the dilution calculation, as they were anti-dilutive.

7. Income Taxes

(a) Income tax provision

The provision for income taxes in the financial statements differs from the result, which would have been obtained by applying the combined federal and provincial tax rate to the Company's earnings before income taxes. This difference results from the following items:

Loss before income taxes	$ (180,156)
Combined federal and provincial tax rate	38.6%
Computed "expected" income tax reduction	(69,540)
Increase (decrease) in income taxes resulting from:	
Non-deductible Crown charges	9,007
Resource allowance inclusion	21,969
Other	4,421
Valuation allowance	34,143
Future income taxes	$ –

(b) Future tax asset

The components of the Company's future income tax asset are as follows:

	2004
Future income tax liabilities:	
Petroleum and natural gas properties	$ (674,642)
Future income tax assets:	
Asset retirement obligations	664,159
Share issue costs	413,951
Non-capital losses	158,917
	1,237,027
Less valuation allowance	(562,385)
Net future income tax asset	$ –

Non-capital losses of $423,000 will expire in 2012.

8. Cash Flow Information

	Period from Incorporation on March 8, 2004 to December 31, 2004
Accounts receivable	$ (204,863)
Prepaid expenses and deposits	(209,348)
Due from related parties	(150,943)
Accounts payable and accrued liabilities	2,429,534
Change in non-cash working capital	$ 1,864,380
These changes relate to the following activities:	
Operating	$ (322,539)
Financing	40,000
Investing	2,146,919
	$ 1,864,380

There were no interest or income taxes paid for the period ended December 31, 2004.

9. Due from Related Parties

During the period ended December 31, 2004 the Company provided technical and administrative support for the oil and natural gas operations of two companies, of which a director and officer of the companies is also a director of the Company. At year end, the Company is owed $150,943 from the related companies, for management fees, administrative recoveries and capital expenditures. These transactions are in the normal course of operations and are measured at the exchange amount established and agreed to by the related parties.

10. Commitments

The Company has future minimum lease payments on office space of $36,908 in 2005 and $23,849 in 2006.

The Company renounced $10,000,000 of qualified expenditures, effective December 31, 2004. The Company has incurred $1,900,000 to December 31, 2004 and has until December 31, 2005 to expend $8,100,000 on qualified expenditures.

11. Financial Instruments

(a) Commodity price risk management

There were no financial instruments in place to manage commodity prices during the period ended December 31, 2004.

(b) Foreign currency exchange risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices received are referenced to U.S. dollar-denominated prices.

(c) Credit risk

A substantial portion of the Company's accounts receivable are with customers and joint-venture partners in the oil and natural gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

(d) Interest rate risk

The Company is exposed to interest-rate risk to the extent that changes in the market interest rates will impact the Company's cash and cash equivalents and bank facility, which have a floating rate of interest.

(e) Fair value of financial instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, prepaid expenses and deposits, amounts due from related parties and accounts payable and accrued liabilities, which approximate their fair values due to their short term to maturity.

12. Subsequent Events

(a) Subsequent to December 31, 2004 the Company acquired all of the issued and outstanding shares of East Prairie Exploration Ltd., a private oil and gas company, of which a director and officer is also a director of the Company. As consideration, the Company issued 451,836 Class A common shares and paid cash of $755,000. The acquisition will be accounted for using the purchase method.

(b) Subsequent to December 31, 2004 the Company issued 870,000 Class A flow-through common shares at $3.50 per share and 3,490,000 Class A common shares at $2.90 per share for gross proceeds of $13,166,000.

(c) Subsequent to December 31, 2004, the Company entered into an agreement to acquire interests in certain petroleum and natural gas properties for gross cash consideration of $16.65 million.

Corporate Information

Directors

Robert Leach [1][2]
Chairman of the Board
Chief Executive Officer of Custom Truck Sales Ltd., President of International Fitness Inc.

Paul Colborne [3][4]
President and Chief Executive Officer of StarPoint Energy Trust

Peter Bannister [1][2]
Vice President, Exploration of Mission Oil and Gas Inc.

John Bowlen [2][3][4]
President and Chief Executive Officer of Regent Resources Ltd.

Denny Hop [1][3]
President of Hop Investment Management, Partner of UniGlobe Travel (Western Canada Ltd.)

P. Dan O'Neil [4]
President and Chief Executive Officer of Breaker Energy Ltd.

(1) Member of the Audit Committee
(2) Member of the Reserves Committee
(3) Member of the Compensation Committee
(4) Member of the Environment, Health and Safety Committee

Management

P. Dan O'Neil
President, Chief Executive Officer and Director

Max Lof
Vice President, Finance and Chief Financial Officer

Dan Polley
Vice President, Exploration

Ian Langdon
Vice President, Engineering

Craig McClelland
Vice President, Land

Ian Temple
Manager, Geophysics

Dan Baumgarten
Manager, Production Operations

James Pasieka
Secretary

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The Bank of Nova Scotia
Calgary, Alberta

Transfer Agent

Olympia Trust Company
Calgary, Alberta

Auditors

KPMG LLP
Chartered Accountants
Calgary, Alberta

Independent Engineers

Gilbert Laustsen Jung Associates Ltd.
Calgary, Alberta

Stock Exchange Listing

TSX Venture Exchange
WAV.A and WAV.B

Abbreviations

bcf	billion cubic feet
bbl	barrel
boe	A boe is a barrel of oil equivalent on the basis of 1 boe to 6 mcf of natural gas. Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 1 boe for 6 mcf is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.
boed	barrels of oil equivalent per day
km	kilometre
mboe	thousand barrels of oil equivalent
mcf	thousand cubic feet
mcfe	thousand cubic feet equivalent
mmbtu	million British Thermal Units
mmcf	million cubic feet

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